

DEPARTMENT OF STATE REVENUE

Revenue Ruling #2018-02ST
July 26, 2018

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ISSUES

Sales and Use Tax - Taxability of Transactions Involving Purchase and Bailment of Manufacturing Equipment

Authority: [IC 6-2.5-1-21](#); [IC 6-2.5-2-1](#); [IC 6-2.5-3-2](#); [IC 6-2.5-4-10](#); [IC 6-2.5-5-3](#); [IC 6-2.5-5-8](#); [45 IAC 2.2-4-2](#); [45 IAC 2.2-4-27](#); *AWHR Am.'s Water Heater Rentals, LLC v. Indiana Dept. of State Revenue*, 941 N.E.2d 573 (Ind. T.C. 2010); *Indiana Dept. of State Revenue v. Belterra Resorts of Indiana, LLC*, 935 N.E.2d 174 (Ind. 2010).

A taxpayer ("Company") seeks a ruling regarding the following issues pertaining to its business:

1. Whether Company is leasing tangible personal property, which would constitute a taxable retail transaction, when it entered into a bailment of manufacturing equipment with its customer.
2. If it is determined that the bailment is a lease, whether Company's purchase and lease of such manufacturing equipment is exempt from sales and use tax because such equipment was acquired for the purpose of leasing, and was leased to a customer for direct use in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of other tangible personal property.

STATEMENT OF FACTS

Company is a foreign corporation with an office in Indiana. Company provides the following information regarding transactions at issue:

1. Company is a design-build contractor in the primary business of constructing industrial buildings in Indiana and elsewhere.
2. [OEM] is a first-tier manufacturer of structural and non-structural automotive body parts from its Indiana manufacturing facility exclusively for [Automotive Manufacturer].
3. OEM and Company entered a contract by which Company designed and built a 124,000 square foot steel building to house OEM's manufacturing equipment and operation ("Building No. 1").
4. OEM later made claims against Company which alleged that certain construction defects in Building No. 1 presented an imminent threat of catastrophic damage to OEM's manufacturing equipment therein that would result in the long-term cessation of OEM's manufacturing operations (the "Claims").
5. OEM and Company entered into a Settlement Agreement and Mutual Release with respect to the Claims (the "Settlement Agreement").
6. The Settlement Agreement requires Company to repair Building No. 1 in exchange for OEM's release of its Claims and other consideration (the "Consideration"). OEM will be unable to use Building No. 1 and the manufacturing equipment located therein while those repairs are ongoing (the "Repair Period"). In order for OEM to continue its manufacturing operations during the Repair Period, the Settlement Agreement also requires Company, at its own expense and in the ordinary course of its business, to construct a temporary building ("Building No. 3"), purchase and locate manufacturing equipment in Building No. 3, and grant OEM the right to possess and use Building No. 3 and the equipment therein during the Repair Period pursuant to a Bailment Agreement (the "Bailment Agreement").
7. Under the Bailment Agreement, Company retains title and ownership of the manufacturing equipment in Building No. 3 at all times, while OEM has possession, use and control of such equipment.
8. OEM is not required to pay for its possession and use of the equipment other than the Consideration.
9. At the end of the Repair Period, possession and use of the equipment reverts to Company and it shall remove such equipment from Building No. 3, unless OEM exercises its option to purchase such equipment at its then fair market value pursuant to the Bailment Agreement.

DISCUSSION

Company requests a determination that (1) its bailment of the manufacturing equipment in Building No. 3 to OEM is a lease for sales and use tax purposes, (2) its purchase of such equipment for the purpose of leasing it to OEM is exempt from sales and use tax under [IC 6-2.5-5-8\(a\)](#), and (3) its receipt of Consideration in exchange for such lease is exempt from sales tax in accordance with [45 IAC 2.2-4-27](#).

Indiana imposes an excise tax called "the state gross retail tax" (or "sales tax") on retail transactions made in Indiana. [IC 6-2.5-2-1\(a\)](#). A person who acquires property in a retail transaction (a "retail purchaser") is liable for the sales tax on the transaction. [IC 6-2.5-2-1\(b\)](#). Indiana also imposes a complementary excise tax called "the use tax" on "the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction." [IC 6-2.5-3-2\(a\)](#).

In general, all purchases of tangible personal property are subject to sales and/or use tax unless an enumerated exemption from sales and/or use tax is available. Property is exempt from use tax if such property is also exempt from sales tax under [IC 6-2.5-3-4\(a\)\(2\)](#), if ". . . the property was acquired in a transaction that is wholly or partially exempt from the state gross retail tax under any part of [IC 6-2.5-5](#), except [IC 6-2.5-5-24\(b\)](#), and the property is being used, stored, or consumed for the purpose for which it was exempted."

The purchase of tangible personal property for lease or rental is exempt pursuant to [IC 6-2.5-5-8\(b\)](#), which provides that "[t]ransactions involving tangible personal property . . . are exempt from the state gross retail tax if the person acquiring the property acquires it for resale, rental, or leasing in the ordinary course of the person's business without changing the form of the property."

The lease or rental of tangible personal property is a taxable retail transaction pursuant to [IC 6-2.5-4-10\(a\)](#), which states that "[a] person, other than a public utility, is a retail merchant making a retail transaction when he rents or leases tangible personal property to another person other than for subrent or sublease." Indiana's regulations at [45 IAC 2.2-4-27\(b\)](#) further states that:

Every person engaged in the business of the rental or leasing of tangible personal property, other than a public utility, shall be deemed to be a retail merchant in respect thereto and such rental or leasing transaction shall constitute a retail transaction subject to the state gross retail tax on the amount of the actual receipts from such rental or leasing.

[IC 6-2.5-1-21\(a\)](#) defines leases, in pertinent part, to include "any transfer of possession or control of tangible personal property for a fixed or indeterminate term for consideration and may include future options to purchase or extend." Pursuant to the same statute, a lease does not include "a transfer of possession or control of property under an agreement that requires the transfer of title upon completion of required payments and payment of an option price that does not exceed the greater of one hundred dollars (\$100) or one percent (1%) of the total required payments[.]"

[45 IAC 2.2-4-27\(c\)](#) provides:

In general, the gross receipts from renting or leasing tangible personal property are subject to tax. The rental or leasing of tangible personal property constitutes a retail transaction, and every lessor is a retail merchant with respect to such transactions. The lessor must collect and remit the gross retail tax or use tax on the amount of actual receipts as agent for the state of Indiana. The tax is borne by the lessee, except when the lessee is otherwise exempt from taxation.

The term "actual receipts" is defined at [45 IAC 2.2-4-27\(d\)](#):

The rental or leasing of tangible personal property, by whatever means effected and irrespective of the terms employed by the parties to describe such transaction, is taxable.

(1) Amount of actual receipts. The amount of actual receipts means the gross receipts from the rental or leasing of tangible personal property without any deduction whatever for expenses or costs incidental to the conduct of the business. The gross receipts include any consideration received from the exercise of an option contained in the rental [or] lease agreement; royalties paid, or agreed to be paid, either on a lump sum or other production basis, for use of tangible personal property; and any receipts held by the lessor which may at the time of their receipt or some future time be applied by the lessor as rentals.

Pursuant to [45 IAC 2.2-4-27\(d\)\(2\)](#), sales tax is due on the lease payments:

Rental or lease period. For purposes of the imposition of the gross retail tax or use tax on rental or leasing transactions, each period for which a rental is payable shall be considered a complete transaction. In the case of a weekly rate, each week shall be considered a complete transaction. In the case of a continuing lease or contract, with or without a definite expiration date, where rental payments are to be made monthly or on some other periodic basis, each payment period shall be considered a completed transaction.

If the lease requires the transfer of title upon completion of required periodic payments and payment of an option price that is less than or equal to one hundred dollars (\$100) or one percent (1%) of the total required payments, whichever is greater, then sales tax is due at the beginning of the lease. Otherwise, sales tax is due on each lease payment. [IC 6-2.5-1-21\(a\)\(2\)](#).

Turning to the present matter to determine whether Company's bailment transaction is a lease of tangible personal property, Company asserts that, in substance, the bailment is a lease for sales and use tax purposes because it transferred possession or control of tangible personal property to OEM for a fixed or indeterminate term for consideration.

In *AWHR Am.'s Water Heater Rentals, LLC v. Indiana Dept. of State Revenue*, 941 N.E.2d 573 (Ind. T.C. 2010), the Indiana Tax Court addressed a similar matter involving a taxpayer which asserted that its transactions were bailments and not leases because it did not transfer possession or control of water heaters it installed. The taxpayer claimed that they were "in the business of providing 'worry-free and economical hot water.'" They installed water heaters in customers' homes, and in exchange the customers "agreed to pay a monthly fee to AWHR." *Id.* at 574. The taxpayer provided the water heaters to its customers "at no charge," bore the expense installing the water heaters, and agreed to make any necessary repairs. It was also agreed that the taxpayer maintained ownership of the water heaters. After an audit, "the Department [of Revenue] determined that AWHR should have collected sales tax from its Indiana customers during the years at issue. More specifically, the Department found that through its Plan, AWHR was leasing tangible personal property to its customers, thereby making the transactions subject to sales tax . . ." *Id.* The taxpayer maintained that it never transferred ownership and control of the water heaters, and therefore the transactions did not constitute leases.

The Court concluded that the transactions involving water heaters constituted lease transactions, reasoning:

Given the facts of this case, AWHR's customers possessed and controlled the water heaters. Indeed, the water heaters were installed in the customers' homes and businesses. To the extent AWHR claims that it had access to the water heaters at all reasonable times, that access was ultimately controlled by the customer. The customers used the water heaters: by turning on the hot-water tap, they decided when they wanted hot water and how much of it they needed (and, therefore, they controlled the water heater's operation). The customers supplied the water and electricity necessary for the water heaters' operation. Accordingly, the Court finds that AWHR's customers had the requisite possession of, and control over, AWHR's water heaters to characterize the transactions as lease transactions. (Internal citations omitted).

Id. at 576. Like the taxpayer at issue in *AWHR*, Company owns the equipment, but OEM has possession and control of the equipment during the Repair Period, all of which supports a conclusion that the bailment transaction constitutes a lease for sales and use tax purpose.

This conclusion is not altered by the fact that OEM is not making any lease or rental payments for the equipment other than the Consideration. As [45 IAC 2.2-4-27\(d\)\(1\)](#) states, "[t]he rental or leasing of tangible personal property, **by whatever means effected and irrespective of the terms employed by the parties to describe such transaction**, is taxable." (**Emphasis added**). Furthermore, the payment of a monthly fee is not determinative, as [45 IAC 2.2-4-27\(d\)\(1\)](#) goes on to explain that any consideration received would be considered gross receipts:

Amount of actual receipts. The amount of actual receipts means the gross receipts from the rental or leasing of tangible personal property without any deduction whatever for expenses or costs incidental to the conduct of the business. The gross receipts include any consideration received from the exercise of an option contained in the rental [or] lease agreement; royalties paid, or agreed to be paid, either on a lump sum or other production basis, for use of tangible personal property; and any receipts held by the lessor which may at the time of their receipt or some future time be applied by the lessor as rentals.

Moreover, the Indiana Supreme Court has determined that "the concept of consideration encompasses any benefit—however slight—accruing to the promisor or any detriment—however slight—borne by the promisee. . . .

[T]he substance, rather than the form, of transactions determines their tax consequences." *Indiana Dept. of State Revenue v. Belterra Resorts of Indiana, LLC*, 935 N.E.2d 174 (Ind. 2010). Here, Company benefitted from the Consideration - OEM's release of its Claims - which were to OEM's detriment.

For all of these reasons, as to Company's first question, Company's bailment of the manufacturing equipment in Building No. 3 should be determined to be a lease of tangible personal property, which is considered a gross retail transaction per [IC 6-2.5-4-10](#).

As to Company's second question, [IC 6-2.5-5-8](#) provides that tangible personal property purchased for the purpose of leasing the property in the ordinary course of the purchaser's business is exempt from the Indiana sales tax. Because Company purchased the manufacturing equipment for the purpose of leasing it in its ordinary course of its business, Company is exempt from sales and use tax on the original purchase.

Regarding Company's third question, [IC 6-2.5-5-3\(b\)](#) provides an exemption for manufacturing machinery, tools, and equipment in pertinent part as follows:

Except as provided in subsection (d), transactions involving manufacturing machinery, tools, and equipment, including material handling equipment purchased for the purpose of transporting materials into activities described in this subsection from an onsite location, are exempt from the state gross retail tax if the person acquiring that property acquires it for direct use in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of other tangible personal property.

[45 IAC 2.2-4-27\(c\)](#) provides that a "lessor must collect and remit the gross retail tax or use tax on the amount of actual receipts . . . except when the lessee is otherwise exempt from taxation." Because OEM leased the manufacturing equipment for direct use in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of other tangible personal property that it will sell to Automotive Manufacturer, Company is exempt from sales and use tax on the Consideration it receives from OEM for its lease of such equipment to OEM.

RULING

Company's bailment of manufacturing equipment to OEM is a lease of tangible personal property for Indiana sales and use tax purposes. Company is exempt to Indiana sales and use tax on its purchase of such equipment and on its lease of such equipment to OEM.

CAVEAT

This ruling is issued to the taxpayer requesting it on the assumption that the taxpayer's facts and circumstances as stated herein are correct. If the facts and circumstances given are not correct, or if they change, then the taxpayer requesting this ruling may not rely on it. However, other taxpayers with substantially identical factual situations may rely on this ruling for informational purposes in preparing returns and making tax decisions. If a taxpayer relies on this ruling and the Department discovers, upon examination, that the fact situation of the taxpayer is different in any material respect from the facts and circumstances given in this ruling, then the ruling will not afford the taxpayer any protection. It should be noted that subsequent to the publication of this ruling a change in statute, regulation, or case law could void the ruling. If this occurs, the ruling will not afford the taxpayer any protection.

Indiana Department of State Revenue

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